

State of Montana

OIL AND GAS LEASE

DS-423
Amended 12/6/05

No. _____

THIS INDENTURE OF LEASE, entered into between the State of Montana, through its Board of Land Commissioners, hereinafter referred to as lessor, and the person, company, or corporation herein named, hereinafter referred to as lessee, pursuant to the provisions of Title 77, Chapter 3, Part 4, M.C.A., and all acts amendatory thereof and supplementary thereto, WITNESSETH:

1. GRANTING CLAUSE--The lessor, in consideration of the annual rentals herein stated, the receipt of which for the first year of this lease is hereby acknowledged, the royalties to be paid, and the covenants to be kept and performed by the lessee, hereinafter set forth, hereby grants, demises, leases and lets to the lessee, for the purpose of mining and operating for oil and gas, and of laying pipelines, building tanks, power stations, and other structures thereon necessary in order to produce, save, care for, dispose of and remove the oil and gas, all the lands herein described, as follows:

Date this lease takes effect:

Name of Lessee:

Address:

Land Located in:

County:

Description of land:

Total number of acres, more or less, _____, belonging to _____ Grant.

Annual rental, payable each year in advance:

2. TERM AND HORIZONTAL SEGREGATION--This lease is granted for a primary term of ten years and so long thereafter as oil and gas in paying quantities shall be produced from the land, subject to all of the terms and conditions herein set forth; provided, however, that:

- (a) The extended term of this lease shall apply only to those formations discovered, developed or drilled during the primary term of ten years, and the interest of the lessee in the premises herein described shall thereafter be limited to such formations.
- (b) If oil and gas in paying quantities is discovered in an offset well on a contiguous section during the extended term of this lease in any formation in the zone between the deepest formation to which the lessee drilled during the primary term of this lease and the deepest formation in which oil or gas has been discovered on the leased premises, this lease shall terminate as to said zone unless, within 60 days after the completion of such offset well, the lessee shall commence operations to test such a formation.

IT IS MUTUALLY UNDERSTOOD, AGREED AND COVENANTED BY AND BETWEEN THE PARTIES TO THIS LEASE AS FOLLOWS:

3. LEASE EXTENSION--The Board of Land Commissioners may grant reasonable extensions of the primary term of this lease upon a showing that lessee, despite due care and diligence, is or has been directly or indirectly prevented from exploring, developing, or operating this lease or is threatened with substantial economic loss due to litigation regarding this lease or another lease in the immediate area held by the lessee, state compliance with the Montana Environmental Policy Act, or adverse conditions caused by natural occurrences.

4. LAND DISPOSITIONS--The lessor expressly reserves the right to sell, lease, or otherwise dispose of any interest or estate in the lands hereby leased, except the interest conveyed by this lease. However, lessor agrees that sales, leases, or other dispositions of any interest or estate in the lands hereby leased shall be subject to the terms of this lease, and shall not interfere with the lessee's possession or rights hereunder.

5. RENTAL--The lessee shall pay to the lessor an annual money rental in the amount hereinabove stated being not less than one dollar and fifty cents (\$1.50) for each acre of land held under this lease from year to year, provided, however, that the amount of such money rental so payable shall in no case be less than one hundred dollars (\$100.00) per

annum. The first year's rental must be paid before the issuance of the lease. The rentals for each subsequent year of the lease shall be due and payable before the beginning of such subsequent lease year. Upon failure to make the rental payment, the lease terminates unless there is a well currently being drilled, a producing well, or a shut-in well approved by the Department of Natural Resources and Conservation, Trust Land Management Division (Department) on the lease. Rental paid for any year must be credited against any royalty that accrues during that year.

6. ROYALTY ON OIL--The lessee shall pay in money or in kind to the lessor at its option as hereinafter provided during the full term of this lease a royalty of 16.67%, free of all costs and deductions, on the average production of the oil from producing wells under this lease for each calendar month.

7. ROYALTY ON GAS--The lessee shall also pay in money or in kind to the lessor at its option as hereinafter provided during the full term of this lease, free of costs and deductions, a royalty on the gas produced from the wells under this lease whether the wells produce oil and gas or gas alone, of 16.67%.

8. SHUT IN GAS ROYALTY--The royalty on gas, including casinghead gas and all gaseous substances not sold or used off the premises, must be at the rate of \$400 per lease each year or the amount of the annual rental provided in the lease, whichever is the greater, payable on or before the annual anniversary date of the lease. As long as the leased lands contain a well capable of production in paying quantities and the requisite payment is made, the lease must be considered as a producing lease under the terms herein.

9. ROYALTIES BASED ON PRODUCTION--All royalties shall be calculated upon the total amount produced and saved under this lease exclusive of oil and/or gas used for light, fuel or operating purposes in connection with the work on the lands under the lease.

10. FULL PRODUCTION REQUIRED--All wells under this lease shall be so drilled, maintained and operated as to produce the maximum amount of oil and/or gas which can be secured without injury to wells and the aforesaid royalties shall be based and calculated on such full production of oil and/or gas.

11. ROYALTY PAYMENT--The lessee shall pay to the lessor in cash for such royalty oil and gas at the rate of the posted field price therefor existing on the day such oil or gas was run into any pipeline or storage tank to the credit of the lessee plus any bonus or other increase in price actually paid or agreed to be paid to the lessee.

12. IN-KIND OIL OR GAS--At the option of the lessor exercised not more frequently than once every thirty days by notice in writing the lessee shall deliver the State's royalty oil or gas free of cost or deductions into the pipeline to which the wells of the lessee may be connected or into any storage designated by the State and connected with such wells. The lessee shall not be required to furnish storage for the State's royalty oil for more than thirty (30) days following the date of production thereof when a market therefor is available.

13. FAIR MARKET VALUE--In all cases where there is no posted field price for oil or gas produced under this lease, the payments in cash for the royalties payable hereunder shall never be less than the fair market value thereof, for oil, at the wells where produced on the day it is run into the pipeline or storage tanks, and for gas, at the well where produced on the day produced. It is agreed that helium gas, carbon dioxide gas, and all other natural gases are included under the term "gas" as used in this lease.

14. LIENS ON PRODUCTION--The lessor shall have a first lien upon all oil or gas produced from the lands leased hereunder, to secure the payment of all unpaid royalty and other sums of money that may become due under the terms herein.

15. POOLING AND UNITIZATION--Upon receiving the written consent of the lessor, the lessee shall have the right to commit the lands hereby leased to a pooling, unit, cooperative or other plan of development or operation with other State lands, Federal lands, privately-owned lands or Indian lands. Such agreements shall not change the percentage of royalties to be paid to the state from the percentages as fixed herein. Oil or gas produced from any lands included in such an agreement which encompasses the lands hereby leased are considered to be produced from the lands hereby leased.

16. FARM LOAN ACQUISITIONS--If the land under this lease is "mortgaged land" acquired by the State in connection with a mortgage given to the State as security for a loan and such mortgage land has been sold by the State subsequent to July 1, 1927, and prior to February 26, 1929, the lessee shall pay directly to the holder of such land under certificate of purchase or other contract, or deed from the State, a royalty of one percentum (1%) of the oil and gas produced from such land to be calculated on the same basis and in the same manner as the royalty to be paid to the State, but the said royalty of one percentum shall be deducted from the royalty to be paid to the State so that such one percentum royalty does not increase the total royalty to be paid under this lease, and if such mortgage land was sold by the State between March 15, 1935, and July 1, 1961, the lessee shall pay directly to the holder of such land under certificate of purchase or other contract or deed from the State, a royalty of six and one-fourth percentum (6¼%) of the oil and gas produced from such land to be calculated as hereinbefore specified.

17. DELAY DRILLING PENALTY--Unless this lease is surrendered, is terminated by lessee's failure to pay rentals when due, or is terminated by the Board of Land Commissioners because of the failure of the lessee to comply with the express and implied covenants of this lease, the Board of Land Commissioners may, in its discretion and as provided by law, cancel and terminate this lease upon the failure of the lessee (1) to commence within five (5) years of the effective date of this lease, drilling of at least one well upon the leased premises of such diameter and to such depth as may be necessary to make a reasonable test for oil and gas; or (2) pay in advance a delay drilling penalty of one dollar and twenty-five cents (\$1.25) per acre for the sixth year of the lease in addition to the annual rental; or (3) pay in advance a delay drilling penalty of two dollars and fifty cents (\$2.50) per acre per annum for the seventh through the tenth year of the lease in addition to the annual rental. The lessee shall notify the Department of the commencement of drilling of any well within five (5) days after the well is spudded in. The Board shall refund delay drilling penalties paid on a lease for any year in which the lessee commences drilling on that lease.

18. DRY HOLE CLAUSE--Following the termination of the fourth year of this lease, if the lessee drills a dry hole on the lease premises prior to discovery of oil or gas or if after discovery of oil or gas, production thereof in paying quantities ceases, the lease may be terminated by the Board unless the lessee (1) commences drilling of another well for oil and/or gas before the 7th year of this lease or second anniversary of the lease following completion of the well, whichever comes later, or (2) unless the lessee, on or before such anniversary date resumes payment of any delay drilling

penalties imposed by the Board. For purposes of this lease "dry hole" is defined as a completed well which is not capable of producing oil and/or gas in paying quantities when completed.

19. DRILLING EXTENSION--If at the expiration of the primary term hereof oil or gas is not being produced from the lease premises in paying quantities, but the owner of the lease is then engaged in drilling on the premises for oil and gas, then the lease continues in effect so long as such drilling operations are being diligently prosecuted. If oil or gas is recovered from any such well drilled or being drilled at or after the expiration of the primary term hereof, the lease continues in effect so long as oil or gas in paying quantities is being produced from the leased premises.

20. DUE DILIGENCE--Upon completion of a commercially productive oil or gas well upon the leased premises, the lessee shall proceed with reasonable diligence to drill such additional wells to the depth of the formation found commercially productive, or to such depth as may be necessary to economically test, develop and operate the deposits discovered.

21. OFFSET PROTECTION--The lessee shall commence promptly and diligently drill to completion all wells necessary on the lands under this lease in order to fairly offset commercially producing oil or gas wells on contiguous lands or pay a compensatory royalty.

22. WASTE PROHIBITED--In conducting all explorations, mining or drilling operations under this lease, the lessee shall exercise all reasonable care and precautions in order to prevent waste of oil and gas. The lessee shall also at all times use all reasonable care and precautions to prevent the entrance of water to the oil or gas bearing strata to the destruction or injury thereof.

23. LOGS REQUIRED--The lessee agrees to keep a correct log of each well drilled under this lease, showing the formations passed through, the depth at which such formation was reached, the thickness of each formation, the water-bearing formations and the character of water therein, the elevations to which the water rises, the number of feet of casing set in such well and where placed, its size and the total depth to which such well was drilled; and upon request, to file the log with the Department.

24. PROGRESS REPORTS REQUIRED--When called upon to do so, the lessee shall also file progress reports with the Department before the completion or abandonment of any well.

25. PRODUCTION REPORTS AND PAYMENT OF ROYALTY--The lessee further agrees on or before the last day of each month to make a report to the Department for operations covering the preceding calendar month, which report shall be in such form as the Department may prescribe and shall show the amount of oil or gas produced and saved during the preceding calendar month, the price obtained therefor, the total amount of all sales, whether any bonus or other increase in price was actually paid or agreed to be paid and such additional information as may be required. Such report shall be signed by the lessee or by some responsible person having knowledge of the facts contained therein. The report shall be accompanied by payment of the amount due the State as royalty for the month covered by the report where payment is required in money in place of oil or gas.

26. COMPLETION REPORTS REQUIRED--When the lessee is required by the rules of the Board of Oil and Gas Conservation to file a well completion report with that board, lessee shall file one copy of that report with the Department.

27. LESSOR'S RIGHT TO INSPECT--Representatives of the lessor shall at all times have the right to enter upon the granted premises and all parts thereof for the purpose of inspecting and examining the same, as well as supervising tests that they may deem necessary to ascertain the condition of the wells being drilled or about to be abandoned and gauging the production of producing wells. Representatives of the lessor shall also, at all reasonable hours, have free access to all books, accounts, records and papers of the lessee insofar as they contain information relating to the production obtained under this lease, the price obtained therefor, and the fair market value of the production. Lessor shall also have free access to agreements relating to production hereunder.

28. SURFACE OWNER'S OR LESSEE'S RIGHTS--The lessee hereunder agrees to provide the surface owner and surface lessee with a plan for location of all facilities and consult with the surface owner and surface lessee regarding a reasonable location of access roads. In all operations on the land hereby leased, lessee agrees to interfere as little as possible with the use of the premises for any other purpose to which the same may be devoted by other persons to whom the land may have been leased or sold by the State. The lessee shall not drill any well upon the lands hereby leased, within two hundred feet (200') of any residence or barn now or hereafter erected thereon without the consent of the owner of such building. The lessee hereby agrees to make satisfactory adjustment with the owner or lessee of the surface, including the State of Montana, for damages sustained by such surface owner, the lessee, or the State of Montana by reason of the lessee's entry upon, use and occupancy of, the surface of the land. If amicable determination of damages cannot be made between such surface owner, lessee, or the State of Montana and the lessee hereunder, then, upon the agreement of the surface owner or lessee to enter into arbitration, the damages to be paid to the surface owner or lessee shall be fixed by a board of arbitrators of three persons, to be appointed as follows: one by the State of Montana or the owner or lessee of the surface who is claiming damages, one by the lessee hereunder, and the third by the two arbitrators so appointed. The lessee hereby agrees to make prompt payment of the damages awarded by such board of arbitrators.

In any case where the owner of the surface claims title under a "C" patent issued by the State of Montana, and demands that the Board fix, allow and pay the owner the reasonable value of any right of way established by the lessee hereunder, the Department shall charge the cost of fixing the amount of damages to the lessee hereunder. The lessee hereunder shall pay the reasonable sum so fixed as damages to the Board, which will pay the surface owner.

29. ASSIGNMENTS--The lessee may assign this lease either in whole or as to any regular subdivision thereof, embracing not less than forty (40) acres, to any qualified assignee, providing that such assignment shall not be binding upon the State until it has been filed with the Department accompanied by the required fees. No assignment to two or more assignees will be approved until one of the assignees is designated to act as agent for the assignees. Each lessee executing this lease, or accepting an assignment of an interest in this lease, is jointly and severally liable for all obligations attributable to the entire working interest under this lease.

30. RELINQUISHMENTS--The lessee shall have the right at the termination of any rental year, by giving at least thirty (30) days previous notice in writing to the Department, to surrender and relinquish any legal subdivisions of the land hereby leased and thereupon be discharged from any obligation not theretofore accrued as to the lands so surrendered and relinquished. When this lease terminates as to any portion less than the whole of the lands covered

hereby, because of the lessee’s failure to pay rental when due, lessee agrees to submit to the lessor, within thirty (30) days after such termination, a written surrender and relinquishment of those lands.

31. CANCELLATION--It is understood and agreed that the lessor hereby reserves the right to declare this lease forfeited and to cancel the same through the Board of Land Commissioners upon failure of the lessee to fully discharge all the obligations provided herein, after written notice from the Board and reasonable time fixed and allowed by it to the lessee for the performance of any undertaking or obligation specified in such notice concerning which the lessee is in default. The lessee, upon written application therefor, shall be granted a hearing on any notice or demand of the Board before the lease shall be declared forfeited or canceled. The provisions of this clause shall not in any way affect an automatic termination of this lease caused by lessee’s failure to pay rental when due.

32. SURRENDER POSSESSION--Upon the termination of this lease for any cause the lessee shall surrender possession of the leased premises to the lessor subject to lessee’s right to re-enter, hereby granted, at any time within six months after the date of such termination, for the purpose of removing all machinery, fixtures, improvements, buildings and equipment belonging to the lessee remaining upon the premises except casing in wells and other equipment or apparatus necessary for the preservation of any oil or gas well or wells. It is hereby agreed that any succeeding lessee, or in the event there be no succeeding lessee, the lessor, wishing to have such property left permanently upon the premises, shall pay the reasonable value thereof, in cash, to the lessee, but if the succeeding lessee or the lessor, acting through its Board of Land Commissioners, shall be unable to agree with the lessee upon the reasonable cash value of such casing, equipment and apparatus, then the succeeding lessee or the lessor herein, as the case may be, shall pay in cash to the lessee hereunder, such sum as may be fixed as a reasonable price by a board of three appraisers, one of whom shall be chosen by the succeeding lessee or the State of Montana as the case may be, one by the lessee hereunder, and the third by the two chosen, and whose appraisal shall be reported to the respective parties, in writing, and is final and conclusive. If the lessee or succeeding lessee refuses to appoint an appraiser within fifteen (15) days of a request to do so by the Department, the Department may appoint an appraiser for the lessee or succeeding lessee. Unless the Department gives written authorization, the lessee may not remain in possession or manage the land and property formerly covered by the lease. During the time the lessee remains in authorized possession, the lessee shall be entitled to retain the same share of the products of the lands as insured to the lessee during the term of this lease. Should the lessor herein or any succeeding lessee not desire any of the lessee’s property permanently left upon the premises, as provided in this paragraph, the lessee shall properly plug all non-producing wells and remove all of his property from the lands with reasonable diligence. If any of the property of the lessee is not removed from the leased premises within six months of the termination date of the lease as herein provided the same shall be deemed forfeited to the State of Montana and shall become its property.

33. COMPLIANCE WITH LAWS, RULES AND REGULATIONS—This lease is subject to further permitting under the provisions of Title 75 or 82, Montana Code Annotated. The lessee agrees to comply with all applicable laws, rules and regulations in effect at the date of this lease, particularly the Rules Governing the Issuance of Oil and Gas Leases on State Lands of the State of Montana. The lessee agrees to comply with all applicable laws, rules and regulations which may, from time to time, be adopted and which do not impair the obligations of this contract and which do not deprive the lessee of an existing property right recognized by law.

34. WARRANTY OF TITLE--It is understood and agreed that this lease is issued only under such title as the State of Montana may now have or hereafter acquire, and that the lessor shall not be liable for any damages sustained by the lessee, nor shall the lessee be entitled to or claim any refund of rentals or royalties theretofore paid to the lessor in the event the lessor does not have the title to the oil and gas in the leased lands. If the lessor owns a lesser interest in the leased lands than the entire and undivided fee simple estate in underlying oil and gas for which rental and royalty is payable, then the rentals and royalties herein provided shall be paid the lessor only in the proportion which its interest bears to the whole and undivided fee simple estate in the oil and gas for which royalty is payable.

35. LEGAL FEES--In the event lessor shall institute and prevail in any action or suit for the enforcement of any provisions of this lease, lessee will pay to lessor a reasonable sum for costs incurred on account thereof.

36. SPECIAL PROVISIONS:

SEE EXHIBIT “A”

37. EXECUTING PARTIES BOUND--All covenants and agreements herein set forth between the parties hereto shall extend to and bind their successors, heirs, executors and assigns.

IN WITNESS WHEREOF, the State of Montana and the lessee have caused this lease to be executed in duplicate and the Director of the Montana Department of Natural Resources and Conservation, pursuant to the authority granted him by the Board of Land Commissioners of the State of Montana, has hereunto set his hand and affixed the seal

of the Board of Land Commissioners this _____ day of _____.

Lessee

Address

Director of the Department of Natural Resources and Conservation